Annual Performance Report

2009-10

Newfoundland and Labrador Government
Sinking Fund

BOARD OF TRUSTEES
NEWFOUNDLAND AND LABRADOR CONSOLIDATED SINKING FUNDS

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
NEWFOUNDLAND AND LABRADOR MUNICIPAL FINANCING CORPORATION SINKING FUND

DEBT MANAGEMENT DIVISION
DEPARTMENT OF FINANCE
CONFEDERATION BUILDING
P.O. BOX 8700
ST. JOHN'S, NL
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September 20, 2010

Message from the Board

I am pleased to present the Annual Performance Report for the Newfoundland and Labrador Government Sinking Fund for the 2009-10 fiscal year.

The Newfoundland and Labrador Government Sinking Fund administers the sinking funds established by the Province of Newfoundland and Labrador for the repayment of the Province's debenture debt. The effective investment and control of these funds is consistent with the Department's responsibilities with respect to stewardship of public money and management of the funded debt and supports the Department's strategic direction and commitment of sound financial management.

This performance report provides an overview of the Newfoundland and Labrador Government Sinking Fund and identifies key issues and results for the Board of Trustees during the fiscal year 2009-10. The Newfoundland and Labrador Government Sinking Fund earned a net income of approximately $43 million during 2009-10, which was net of a foreign exchange loss of $5.2 million, resulting from a decline in the value of the U.S. dollar.

The Board of Trustees is accountable for the preparation of this report and for the results reported therein.

Terry Paddon
Chairman

1.0 Overview

The Newfoundland and Labrador Government Sinking Fund was created pursuant to the *Financial Administration Act* to consolidate and administer sinking funds established for the repayment of the Province's debenture debt. The Province has established sinking funds for most of its long term debenture issues and the annual contributions to these sinking funds are invested by the Board of Trustees of the Newfoundland and Labrador Consolidated Sinking Funds, appointed by the Lieutenant Governor in Council to manage and control the day to day operation of the sinking funds. As at 31 March 2010, the Board of Trustees consists of the incumbents in five senior public service positions with the Department of Finance as follows:

Terry Paddon	Deputy Minister
Ronald Williams	Comptroller General
Robert Constantine	Assistant Deputy Minister Taxation and Fiscal Policy
Paul Myrden	Director, Debt Management
Linda Howell	Manager of Debt Servicing & Financial Risk

The Newfoundland and Labrador Government Sinking Fund operates with a March 31 fiscal year end and the results of its activities are fully consolidated in the Province's annual financial statements.

2.0 Mandate

The mandate of the Board of Trustees is to manage and control the operational activities of the Newfoundland and Labrador Government Sinking Fund and the sinking funds of certain Crown corporations where the Province has guaranteed the related debt (i.e. Newfoundland and Labrador Municipal Financing Corporation and the Eastern Regional Integrated Health Authority). These activities include setting investment policy, investment of funds and the monitoring of such. These funds are invested in accordance with the *Financial Administration Act,* primarily in bonds, debentures or other securities issued or guaranteed by the Government of Canada, the government of a province of Canada, or a chartered bank, with the goal of earning the maximum return from investment of the portfolio while ensuring security of the funds.

3.0 Sources of Funding

For debenture issues which have sinking fund requirements, the Province makes the required sinking fund contributions to the Board of Trustees. In 2009-10, these sinking fund payments amounted to $51,187,000. Sinking fund contributions are invested and the interest earnings, less an amount to cover administrative costs, are re-invested.

The Newfoundland and Labrador Government Sinking Fund's day-to-day activities are managed by employees of the Department of Finance and the Sinking Fund is invoiced quarterly by the Province for reimbursement of these expenses on a cost-recovery basis.

4.0 Financial Statements

The Newfoundland and Labrador Government Sinking Fund earned a net income of approximately $43 million during 2009-10, after a foreign exchange loss of $5.2 million, resulting from a decline in the value of the U.S. dollar. Any gains or losses resulting from foreign currency translations will not become realized until such time that the U.S. assets should ever actually be converted to Canadian dollars. Financial statements for the year ending 31 March 2010 are included in this report.

5.0 2008-11 Activity Plan Update

The Newfoundland and Labrador Government Sinking Fund supports the Department of Finance in its responsibilities related to stewardship of public money and fiscal management by the investing of funds in accordance with parameters set out in the *Financial Administration Act*. A review of the investment strategy of the fund was begun in 2007-08 and was ongoing in 2009-10. As part of this review, the three year activity plan of the NL Government Sinking Fund set forth the following goal and objectives for the Fund:

Goal:
By March 31, 2011, the Newfoundland and Labrador Government Sinking Fund will have implemented any changes recommended to the investment strategy of the fund resulting from the review of that investment strategy and will have formally documented the investment policies of the fund.

2009-10 Objective:
By March 31, 2010, the Newfoundland and Labrador Government Sinking Fund will have updated the documentation for the investment policy of the sinking fund.

Measure: Formal documentation of investment policy of sinking fund.

Indicator: Documentation completed.

Progress: Changes to the investment strategy, as approved by the Board, are appropriately documented in the records (i.e., minutes) of the Board's meetings. These changes are supplementary to those previously approved by the Board and documented in its policies and investment objectives. The Board has now decided to develop a new policy document, the purpose of which will be to summarize all current investment objectives and policies. It is anticipated that this new policy document will be completed during the 2010-11 fiscal year.

6.0 Intended Results for the 2010-11 Fiscal Year

The Board of Trustees has identified the following objective, measure and indicator as its priority for the 2010-11 fiscal year:

2010-11 Objective:

By March 31, 2011 the Newfoundland and Labrador Government Sinking Fund will have completed an annual review of the investment strategy and policies of the sinking fund.

Measure: Review of investment strategy and policies.

Indicator: Review completed.

7.0 Highlights and Accomplishments

During the year 2009-10 the Sinking Fund had a net income of $43,332,000.

8.0 Opportunities and Challenges

The unpredictable nature of the investment market will continue to challenge the Board of Trustees to ensure that its investment strategy maximizes the rate of return earned on its investment portfolio while at the same time, protects the security of the sinking funds.

A slow global recovery continues during 2010. As the economies improve further, it is anticipated that there will be an opportunity to increase the earning potential of the investment strategy.

Financial Statements
(attached)

NEWFOUNDLAND AND LABRADOR
GOVERNMENT SINKING FUND

FINANCIAL STATEMENTS

31 MARCH 2010

OFFICE OF THE AUDITOR GENERAL
St. John's, Newfoundland and Labrador

AUDITOR'S REPORT

To the Board of Trustees
Newfoundland and Labrador Government Sinking Fund
St. John's, Newfoundland and Labrador

I have audited the balance sheet of the Newfoundland and Labrador Government Sinking Fund as at 31 March 2010 and the statements of statutory contributions, retained earnings, revenues and expenses, and cash flows for the year then ended. These financial statements are the responsibility of the Board's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at 31 March 2010 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

JOHN L. NOSEWORTHY, CA
Auditor General

St. John's, Newfoundland and Labrador
24 June 2010

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
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31 March 2010

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NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND

BALANCE SHEET

31 March	2010	2009
	(000's)	(000's)
ASSETS		
Current		
Cash	$ 39,538	$ 32,346
Term deposits and short-term investments	11,885	-
Interest and other receivables		
Province of Newfoundland and Labrador - guaranteed	9,629	10,497
Other	2,556	2,918
	63,608	45,761
Investments, at amortized cost (Schedule 1)		
Cost	691,880	736,167
Accumulated amortization of discounts and premiums	100,978	94,951
	792,858	831,118
	$ 856,466	$ 876,879
LIABILITIES AND SINKING FUND EQUITY		
Current		
Accounts payable and accrued liabilities	$ 13	$ 11
Due to Province of Newfoundland and Labrador	219	347
	232	358
Sinking fund equity		
Statutory contributions (Statement 2)	487,319	489,231
Retained earnings (Statement 3)	368,915	387,290
	856,234	876,521
	$ 856,466	$ 876,879

See accompanying notes

Signed on behalf of the Board:

Chairperson **Member**

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF STATUTORY CONTRIBUTIONS
For the Year Ended 31 March

	2010 (000's)	2009 (000's)
Balance, beginning of year	**$ 489,231**	$ 408,558
Statutory contributions for the year	**51,187**	52,967
	540,418	461,525
Statutory contributions applicable to matured/redeemed debentures	**(22,350)**	-
Foreign currency translation adjustment (Note 2)	**(30,749)**	27,706
Balance, end of year	**$ 487,319**	$ 489,231

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF RETAINED EARNINGS
For the Year Ended 31 March

	2010	2009
	(000's)	(000's)
Balance, beginning of year	$ 387,290	$ 318,271
Excess of revenues over expenses	43,332	49,643
	430,622	367,914
Retained earnings applicable to matured/redeemed debentures	(36,329)	(3,227)
Foreign currency translation adjustment (Note 2)	(25,378)	22,603
Balance, end of year	$ 368,915	$ 387,290

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF REVENUES AND EXPENSES
For the Year Ended 31 March

	2010 (000's)	2009 (000's)
REVENUES		
Interest income		
Debentures	$ 38,000	$ 33,524
Term deposits and short-term investments	1	1,987
Other	256	211
	38,257	35,722
Foreign currency translation gains (losses) (Note 2)	(5,248)	4,260
Amortization of discounts and premiums	10,568	9,902
	43,577	49,884
EXPENSES		
Salaries and benefits	145	138
General	100	103
	245	241
Excess of revenues over expenses	$ 43,332	$ 49,643

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF CASH FLOWS
For the Year Ended 31 March

	2010	2009
	(000's)	(000's)
Cash flows from operating activities		
Excess of revenues over expenses	$ 43,332	$ 49,643
Adjustment for non-cash items		
Amortization of discounts and premiums	(10,568)	(9,902)
Foreign currency translation (gains) losses (Note 2)	5,248	(4,260)
	38,012	35,481
Change in non-cash working capital	1,104	(2,706)
	39,116	32,775
Cash flows from financing activities		
Statutory contributions	51,187	52,967
	51,187	52,967
Cash flows from investing activities		
Purchase of investments	(64,877)	(166,625)
Proceeds from redemption and sale of investments	54,964	-
Payments of excess to Province upon maturing debentures	(58,679)	(3,227)
	(68,592)	(169,852)
Net (decrease) increase in cash and cash equivalents	21,711	(84,110)
Effect of foreign currency translation adjustment (Note 2)	(2,634)	8,949
Cash and cash equivalents, beginning of year	32,346	107,507
Cash and cash equivalents, end of year	$ 51,423	$ 32,346
Cash and cash equivalents include:		
Cash	$ 39,538	$ 32,346
Term deposits and short-term investments	11,885	-
	$ 51,423	$ 32,346

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
SCHEDULE OF INVESTMENTS
31 March

	2010		2009	
	Face Value or Par (000's)	**Amortized Cost (000's)**	Face Value or Par (000's)	Amortized Cost (000's)
Canadian				
Province of Newfoundland and Labrador - guaranteed				
Province of Newfoundland and Labrador	**$ 151,195**	**$ 161,426**	$ 146,544	$ 156,896
Newfoundland and Labrador Municipal Financing Corporation	**19,350**	**19,342**	24,790	24,785
Newfoundland and Labrador Hydro	**30,248**	**35,977**	20,999	24,993
Coupons and residuals	**311,456**	**180,358**	322,890	181,668
	512,249	**397,103**	515,223	388,342
Other securities	**77,667**	**80,111**	94,806	95,933
Other coupons and residuals	**109,570**	**61,600**	71,314	44,171
	699,486	**538,814**	681,343	528,446
U.S.				
Province of Newfoundland and Labrador - guaranteed				
Province of Newfoundland and Labrador	**124,999**	**140,672**	152,864	173,377
Other securities	**81,690**	**98,869**	97,027	118,639
Other coupons and residuals	**24,222**	**14,503**	18,506	10,656
	230,911	**254,044**	268,397	302,672
Total investments	**$ 930,397**	**$ 792,858**	$ 949,740	$ 831,118

See accompanying notes

Authority

The Province of Newfoundland and Labrador issues debentures, most of which have sinking fund requirements. For debentures which have sinking fund requirements, the Province makes the required sinking fund payments (statutory contributions) to the Board of Trustees of the Newfoundland and Labrador Government Sinking Fund. This is an unincorporated body formed under the *Financial Administration Act.* All members of the Board are full-time employees of the Province and are appointed by the Lieutenant-Governor in Council.

1. Basis of accounting

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Outlined below are the significant policies followed.

(a) Cash and cash equivalents

Cash and cash equivalents include balances with banks, and term deposits and short-term investments with original maturities of three months or less.

Short-term deposits are recorded at cost which approximates market value because of the short-term nature of the securities.

(b) Investment transactions

(i) Purchases: Investments are initially recorded at cost.

(ii) Amortization: Discounts and premiums are amortized on a straight-line basis from the date of purchase until maturity.

(iii) Sales: Sales of investments are at a negotiated selling price. Sales are recorded at the proceeds less the investment's average amortized cost, with any resulting gain or loss also recorded.

(iv) Redemptions: On occasion, investments held in the Fund will be called for redemption by the issuer. In such instances, a gain is recorded equal to the redemption proceeds less the investment's average amortized cost.

1. Basis of accounting (cont.)

(c) Maturity of a Province of Newfoundland and Labrador debenture issue for which a sinking fund has been provided

(i) General

Provision is made for redemption at debenture maturity by investing statutory contributions in interest bearing securities and other investments. Both the contributions and the interest are used to pay debenture holders when debentures mature.

A record is maintained of statutory contributions received on account of each issue and of income allocated to each issue (retained earnings). The dollar total of an issue's statutory contributions and allocated income is called its Sinking Fund Value.

At maturity, statutory contributions are reduced by the total amount of statutory contributions received over the life of the issue. Retained earnings are reduced by the excess of the debenture's Sinking Fund Value over statutory contributions received.

(ii) Cash flow

At maturity, cash is paid into a redemption bank account in an amount equal to the lesser of the total face value of the issue or the Sinking Fund Value of the issue, less the face value of the issue held in the Fund's investments. If the issue's Sinking Fund Value exceeds the total face value, the excess is paid to the Consolidated Revenue Fund of the Province of Newfoundland and Labrador. If the issue's Sinking Fund Value is less than the total face value, the difference is paid into the redemption bank account by the Province.

(d) Cancellation of Province of Newfoundland and Labrador debentures held by the Sinking Fund upon related sinking fund debentures becoming fully funded

When the value of a sinking fund for a debenture issue equates to the outstanding principal amount of that issue, the Sinking Fund will return to the Province for cancellation any debentures of that issue held by the Sinking Fund. The cancellation of sinking fund assets results in a corresponding reduction in sinking fund equity. Interest income continues to be allocated to the sinking fund until maturity of the related debenture issue and is returned to the Province annually.

(e) Interest income

Interest income is recorded on an accrual basis.

(f) Foreign currency translation

Assets, liabilities, revenues and expenses denominated in U.S. currency are translated as follows:

(i) assets and liabilities are translated at the rate of exchange in effect at the balance sheet date; and

1. Basis of accounting (cont.)

(f) Foreign currency translation (cont.)

(ii) revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such.

Gains and losses resulting from foreign currency translation are amortized on a straight-line basis over the remaining life of each issue's sinking fund.

2. Effect of foreign currency translation

At 31 March 2010, the Fund held $792,858,000 (2009 - $831,118,000) in investments as shown in Schedule 1. These investments include $254,044,000 in U.S. investments (2009 - $302,672,000).

The Fund assets, liabilities, statutory contributions and retained earnings denominated in U.S. currency are translated at the rate of exchange in effect at the balance sheet date. The Fund's revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such. It is not the intention of the Fund that its U.S. assets will be converted into Canadian dollars.

In 2010, the translation of U.S. assets at year end resulted in a net foreign exchange loss due to a decrease in the value of the U.S. dollar. In 2009, the translation of U.S. assets at year end resulted in a net foreign exchange gain due to an increase in the value of the U.S. dollar. Any gains or losses resulting from foreign currency translations will not become realized until such time that U.S. assets should ever actually be converted to Canadian dollars.

		2010 (000's)		2009 (000's)
The effect of the translation is as follows:				
Statutory contributions have been increased (decreased) by	$	**(30,749)**	$	27,706
Retained earnings have been increased (decreased) by		**(25,378)**		22,603
Excess of revenues over expenses has been increased (decreased) by		**(5,248)**		4,260
Total impact of foreign currency translation		**(61,375)**		54,569
The effect of this amount on the Fund Assets is as follows:				
Investments have been increased (decreased) by		**(58,741)**		45,620
Cash and cash equivalents have been increased (decreased) by	$	**(2,634)**	$	8,949

3. Financial instruments

The Newfoundland and Labrador Government Sinking Fund's short-term financial instruments recognized on the balance sheet consist of cash, term deposits and short-term investments, interest and other receivables, accounts payable and accrued liabilities, and due to Province of Newfoundland and Labrador. The carrying values of these instruments approximate current fair value due to their nature and the short-term maturity associated with them.

The Fund usually holds short-term investments in addition to the long-term investments. However, in 2009, the Fund held no short-term investments due to weakness in the rates available in the market. The cost approximates the face value as these investments are made in term deposits and guaranteed bonds with maturity occurring within 3 months or less after the initial investment. Therefore, their reported value is fair value to the Fund and there is no rate risk associated with these investments.

The Fund holds long-term investments which have an amortized cost of $792,858,000 (2009 - $831,118,000). The face value of these investments is $930,397,000 (2009 - $949,740,000). The policy and intention of the Board is to hold these long-term investments to maturity. Therefore, their reported value is current fair value to the Fund and there is no rate risk associated with these investments.

4. Income taxes

The Newfoundland and Labrador Government Sinking Fund is a Crown entity of the Province of Newfoundland and Labrador and as such is not subject to Provincial or Federal income taxes.